

Yum China (YUMC US)

Likely to be resilient and outperform in 2H23E

2Q23 result was resilient, and both SSSG and margins are strong. YUMC is still one of our sector top picks, as we think its margin and store expansion will remain strong and perhaps surprise the market. Hence, we maintain BUY and fine-tuned TP to US\$ 74.47, based on 27x FY24E P/E (unchanged).

■ **Another resilient result in 2Q23.** In 2Q23, YUMC's sales increased by 25% YoY to US\$ 2.65bn, 5% higher vs CMBI est. but 6% lower vs BBG est. while net profit surged by 137% YoY to US\$ 197mn, better than CMBI est. and BBG est. by 13% and 4%. We think the rapid sales growth was due to: 1) robust SSSG of 15% (beat CMBI est. of 9% and speeded up from 8% in 1Q23) and adjusted SSSG of 24% (even better than industry average of 20%), 2) strong rebound of transportation hubs and tourists' attractions and 3) acceleration in store opening (from 9% in 1Q23 to 25% in 2Q23). Margins were also encouraging, where KFC/ Pizza Hut's restaurant OP margin reached 17.3%/ 12.4%, higher than 2Q19's 15.4%/ 11.4%, thanks to: 1) resilient GP margin (more targeted marketing efforts and rollout of innovative products to offset the drop in ASP (by 5%/ 11% for KFC/ Pizza Hut) and more aggressive promotions), 2) strong operating leverage and 3) significant improvements in store economics for the 40% new stores opened after 2019.

■ **Both sales and margins could still be solid in 2H23E.** We are now more optimistic about the SSSG in 2H23E (revise up to 8%, from 5%), even though it would mean a slowdown vs 1H23E. But that is supported by: 1) strong beat in 2Q23 and sequential improvement in Jun vs May 2023, 2) strong buying power during peak holidays season and momentum at transportation hubs and around tourists' attractions (already back to 2019 level), 3) more exciting new products and promotions as YUMC sees sales growth as its priority in 2023. Margin-wise, we expect 11.1% OP margin in 2H23E (vs 12.1% in 1H23 and 9.1% in 2H19) thanks to the more efficient business model vs 2019. While poultry price is on the rise in 2H23E, greater sales from the higher margin and innovative products (e.g. whole chicken and burgers) can help GP margin to remain stable vs last year. We expect staff costs inflation to up by LSD to MSD in 2H23E (vs just MSD increases in 1H23), which is a mixture of increases in min. wages in many regions, further increase in labour productivity through better staff scheduling and more sharing between stores. Since more than 40% of stores were newly opened after 2019, per store economics and margins also tend to be better. We are still cautiously optimistic about operating leverage, which is still the most important driver for margin improvement.

■ **Maintain BUY and raise TP to US\$ 74.47.** Our new TP is based on 27x FY24E P/E (unchanged), at par with 5 years avg. and supported by resilient performance despite an industry-wide weakness. We fine-tuned FY23E/ 24E/ 25E NP by -1%/ +1%/ +1% to factor in faster sales and lower GP margin. YUMC is currently trading at 22x FY24E P/E, not too demanding.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (US\$ mn)	9,853	9,569	11,217	12,576	14,120
YoY growth (%)	19.2	(2.9)	17.2	12.1	12.3
Operating profit (US\$ mn)	1,386	629	1,301	1,552	1,923
Net profit (US\$ mn)	990.0	442.0	899.0	1,166.7	1,448.0
EPS (Reported) (US\$)	2.28	1.04	2.18	2.76	3.42
YoY growth (%)	17.0	(54.2)	108.6	26.5	24.1
P/E (x)	26.9	58.7	28.2	22.2	17.9
P/B (x)	3.4	3.4	3.2	2.9	2.5
Yield (%)	0.8	1.1	1.1	1.4	1.7
ROE (%)	13.8	5.9	11.9	13.9	15.2

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$74.47
 (Previous TP) US\$73.71
Up/Downside 22.0%
Current Price US\$61.02

China Consumer Discretionary

Walter WOO
 (852) 3761 8776
 walterwoo@cmbi.com.hk

Raphael TSE
 (852) 3900 0856
 raphaeltse@cmbi.com.hk

Stock Data

Mkt Cap (US\$ mn) 25,567.4
 Avg 3 mths t/o (US\$ mn) 93.0
 52w High/Low (US\$) 64.36/38.84
 Total Issued Shares (mn) 419.0
 Source: FactSet

Shareholding Structure

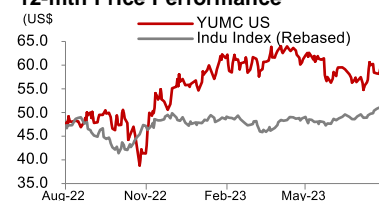
JPMorgan Chase & Co. 10.5%
 Invesco Advisers, Inc. 8.0%
 Source: HKEx

Share Performance

	Absolute	Relative
1-mth	8.0%	4.5%
3-mth	-0.3%	-4.4%
6-mth	-1.0%	-5.1%

Source: FactSet

12-mth Price Performance



Source: FactSet

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- **Store opening plan target for FY23E remains unchanged but we are optimistic.** YUMC opened about 665 stores to 13,602 in 1H23, consisting of 468/ 169/ 18 stores for KFC/ Pizza Hut/ other brands. While the management reiterated its full year target of 1,100 to 1,300, we believe there is room for upward revision, as the new stores in 1H23 had already accounted for 50%-60% FY23E target, compared to historical average of 45%.

Earnings revision

Figure 1: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	11,217	12,576	14,120	11,069	12,411	13,934	1.3%	1.3%	1.3%
Gross profit	7,927	8,920	10,025	7,845	8,803	9,894	1.1%	1.3%	1.3%
Operating Profit	1,301	1,552	1,923	1,313	1,544	1,914	-1.0%	0.5%	0.5%
Net profit	899	1,167	1,448	905	1,155	1,433	-0.7%	1.0%	1.0%
EPS (US\$ cents)	2.179	2.758	3.423	2.195	2.730	3.389	-0.7%	1.0%	1.0%
Gross margin	70.7%	70.9%	71.0%	70.9%	70.9%	71.0%	-0.2ppt	0ppt	0ppt
EBIT margin	11.6%	12.3%	13.6%	11.9%	12.4%	13.7%	-0.3ppt	-0.1ppt	-0.1ppt
Net profit att. margin	8.0%	9.3%	10.3%	8.2%	9.3%	10.3%	-0.2ppt	0ppt	0ppt

Source: Company data, CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

US\$ mn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	11,217	12,576	14,120	11,380	12,833	14,159	-1.4%	-2.0%	-0.3%
Gross profit	7,927	8,920	10,025	8,293	9,379	9,989	-4.4%	-4.9%	0.4%
Operating Profit	1,301	1,552	1,923	1,265	1,500	1,750	2.8%	3.5%	9.9%
Net profit	899	1,167	1,448	910	1,099	1,271	-1.2%	6.2%	13.9%
EPS (US\$ cents)	2.179	2.758	3.423	2.194	2.663	3.102	-0.7%	3.6%	10.3%
Gross Margin	70.7%	70.9%	71.0%	72.9%	73.1%	70.5%	-2.2ppt	-2.2ppt	0.5ppt
Operating Margin	11.6%	12.3%	13.6%	11.1%	11.7%	12.4%	0.5ppt	0.7ppt	1.3ppt
Net Margin	8.0%	9.3%	10.3%	8.0%	8.6%	9.0%	0ppt	0.7ppt	1.3ppt

Source: Company data, CMBIGM estimates

Assumptions

Figure 3: CMBIGM's assumptions

Major assumptions	FY21A	FY22A	FY23E	FY24E	FY25E
Sales by segment (US\$ mn)					
KFC - dine in sales	4,818	4,457	5,148	5,627	6,267
KFC - delivery sales	2,185	2,762	3,354	3,938	4,506
PH - dine in sales	1,340	1,125	1,335	1,478	1,705
PH- delivery sales	769	835	977	1,124	1,225
Others	741	390	403	410	417
Total	9,853	9,569	11,217	12,576	14,120
Sales by segment growth (%)					
KFC - dine in sales	16.0%	-7.5%	15.5%	9.3%	11.4%
KFC - delivery sales	34.7%	26.4%	21.4%	17.4%	14.4%
PH - dine in sales	17.0%	-16.1%	18.7%	10.7%	15.4%
PH- delivery sales	19.8%	8.6%	17.0%	15.0%	9.0%
Others	5.7%	-47.4%	3.3%	1.7%	1.8%
Total	19.2%	-2.9%	17.2%	12.1%	12.3%
Sales network by brand					
KFC	8,168	9,094	10,034	10,974	11,914
Pizza Hut	2,590	2,903	3,223	3,563	3,903
Others	1,030	950	990	1,040	1,120
Total	11,788	12,947	14,247	15,577	16,937
Restaurant profit margin by brand					
KFC	14.5%	15.5%	19.2%	19.5%	20.7%
Pizza hut	10.6%	9.1%	12.5%	13.8%	14.8%
Others	-1.3%	-4.6%	-0.2%	0.4%	0.5%
Total	13.7%	14.1%	17.9%	18.4%	19.6%
Costs breakdown					
Food and paper/ sales	28.5%	29.6%	29.3%	29.1%	29.0%
Payroll and employee benefits/ sales	22.9%	25.0%	23.9%	23.9%	23.7%
Rental and other operating expenses/ sales	27.0%	27.2%	25.4%	25.5%	25.0%
G & A expenses/ sales	5.7%	6.2%	6.0%	5.8%	5.6%
Franchisees expenses/ sales	6.6%	2.9%	2.5%	2.2%	1.9%
Effective tax rate	26.5%	30.4%	30.0%	25.0%	25.0%
NP att. margin	10.0%	4.6%	8.0%	9.3%	10.3%
NP att. growth (%)	26.3%	-55.4%	103.4%	29.8%	24.1%

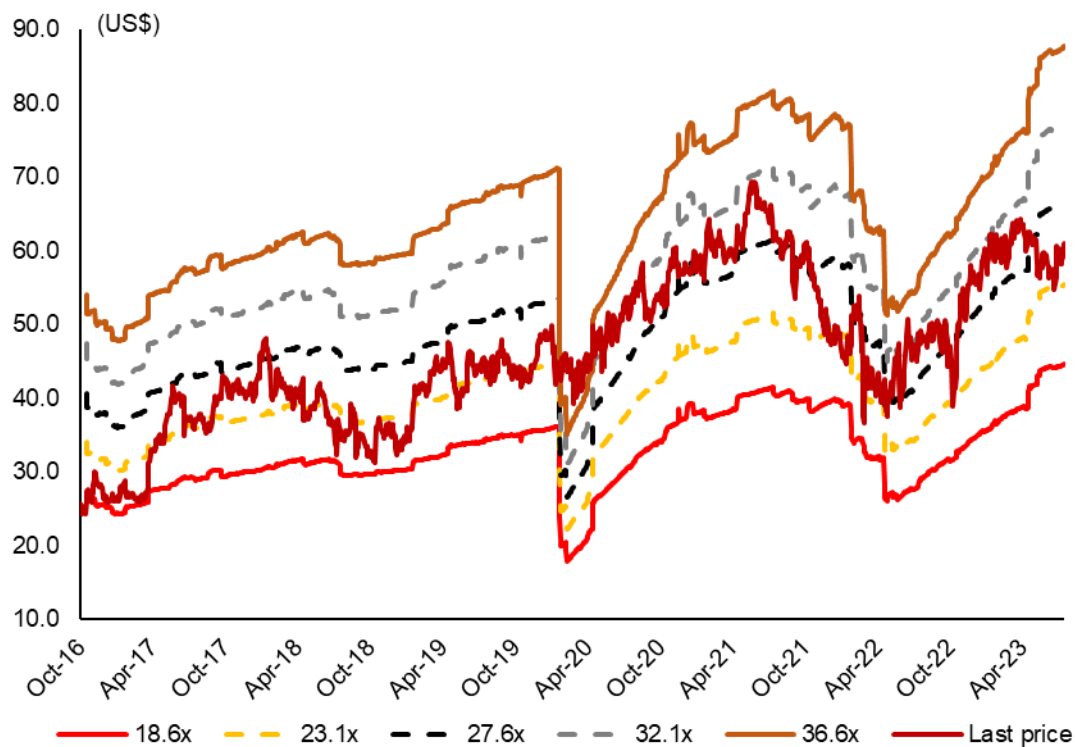
Source: Company data, CMBIGM estimates

Valuation

Figure 4: Peers valuation table

			12m TP	Price	Up/ Down-	Mkt. Cap	Year	P/E (x)		P/B (x)	ROE (%)	3yrs PEG (x)	Yield (%)	YTD perf.
Company	Ticker	Rating	(LC)	(LC)	side	(HK\$mn)	End	FY1E	FY2E	FY2E	FY2E	FY1E	FY1E	FY1E
Leading Greater China Catering														
Yum China	YUMC US	BUY	74.47	61.02	22%	210,625	Dec-22	28.5	22.9	3.4	5.9	0.6	1.0	14.8
Jiumaojiu	9922 HK	BUY	17.21	15.04	14%	21,876	Dec-22	34.2	21.5	4.4	1.6	0.2	0.7	(27.9)
Haidilao	6862 HK	BUY	23.96	22.15	8%	123,464	Dec-22	31.1	25.1	7.8	17.9	0.6	0.9	(1.1)
Nayuki	2150 HK	BUY	8.75	5.32	64%	9,124	Dec-22	28.6	13.6	1.4	(9.7)	(0.1)	0.2	(29.3)
Helens	9869 HK	NR	n/a	8.93	n/a	11,313	Dec-22	27.2	17.1	3.8	(68.1)	(0.2)	0.3	(39.7)
Tam Jai	2217 HK	NR	n/a	1.73	n/a	2,320	Mar-23	10.2	7.5	1.3	9.1	0.3	2.9	(34.2)
Cafe De Coral	341 HK	BUY	12.32	10.24	20%	5,998	Mar-23	19.2	14.1	2.0	3.9	0.3	5.0	(31.3)
Xiabuxiabu	520 HK	NR	n/a	4.80	n/a	5,214	Dec-22	17.2	10.8	2.4	(20.6)	(0.1)	1.8	(45.6)
Yihai	1579 HK	BUY	108.52	17.72	512%	18,370	Dec-22	18.8	16.1	2.8	18.3	1.4	1.6	(35.1)
Gourmet Master	2723 TT	NR	n/a	121.50	n/a	5,400	Dec-22	20.9	15.7	1.7	4.3	0.4	3.2	(19.8)
Avg.								23.5	16.4	3.0	(3.7)	0.3	1.8	(25.6)
Med.								24.0	15.9	2.6	4.1	0.3	1.3	(30.3)
International Catering														
Yum! Brands	YUM US	NR	n/a	137.67	n/a	300,522	Dec-22	26.9	23.3	n/a	n/a	2.0	1.7	7.5
Mcdonald's	MCD US	NR	n/a	293.20	n/a	1,668,347	Dec-22	25.6	23.7	n/a	n/a	1.5	2.1	11.3
Starbucks Corp	SBUX US	NR	n/a	101.57	n/a	907,497	Oct-22	29.7	24.8	n/a	n/a	1.6	2.1	2.4
Rest' Brands	QSR US	NR	n/a	76.56	n/a	270,014	Dec-22	24.4	22.5	7.9	41.7	5.2	2.9	18.4
Chipotle	CMG US	NR	n/a	1962.3	n/a	421,909	Dec-22	45.2	37.3	16.0	45.3	1.8	0.0	41.4
Darden	DRI US	NR	n/a	168.92	n/a	159,391	May-23	19.4	17.5	8.3	44.6	1.9	3.1	22.1
Domino's Pizza	DPZ US	NR	n/a	396.74	n/a	108,514	Jan-23	29.0	25.3	n/a	n/a	2.5	1.2	14.5
Wendy's Co	WEN US	NR	n/a	21.49	n/a	35,296	Jan-23	21.9	19.2	28.3	41.1	1.5	4.7	(5.0)
Shake Shack	SHAK US	NR	n/a	77.66	n/a	25,572	Dec-22	473.5	262.4	7.6	(3.9)	(2.4)	n/a	87.0
Wingstop Inc	WING US	NR	n/a	168.58	n/a	39,375	Dec-22	78.2	67.8	n/a	n/a	4.0	0.5	22.5
Jollibee Foods	JFC PM	NR	n/a	261.00	n/a	41,519	Dec-22	35.0	28.3	3.5	9.9	1.9	1.1	13.5
Avg.								73.5	50.2	11.9	29.8	2.0	1.9	21.4
Med.								29.0	24.8	8.1	41.4	1.9	1.9	14.5
H-shares Consumer Staples														
UPC	220 HK	NR	n/a	6.64	n/a	28,680	Dec-22	15.8	14.4	1.9	9.1	0.9	7.0	(15.0)
Tingyi	322 HK	NR	n/a	11.66	n/a	65,697	Dec-22	17.0	14.1	4.3	16.4	0.8	6.1	(13.5)
Want Want	151 HK	NR	n/a	5.48	n/a	65,099	Mar-23	14.8	13.7	3.5	21.6	1.5	5.5	5.0
China Mengniu*	2319 HK	BUY	57.00	28.35	101%	111,755	Dec-22	16.5	14.2	2.0	13.8	1.2	1.7	(18.8)
Nongfu Spring*	9633 HK	BUY	53.00	45.30	17%	509,465	Dec-22	48.7	41.8	14.6	37.9	4.0	1.6	2.7
Vitasoy	345 HK	NR	n/a	10.78	n/a	11,565	Mar-23	63.4	31.1	3.4	1.5	0.5	1.0	(32.9)
Budweiser*	1876 HK	BUY	27.20	18.68	46%	247,387	Dec-22	28.5	24.0	2.6	8.4	1.6	1.5	(23.9)
Tsingtao*	168 HK	BUY	86.00	68.10	26%	119,134	Dec-22	19.6	16.9	2.7	15.7	1.6	2.8	(11.0)
CR Beer*	291 HK	BUY	71.00	48.80	45%	158,316	Dec-22	26.9	22.2	4.3	16.9	1.4	1.5	(10.5)
Dali Foods	3799 HK	NR	n/a	3.62	n/a	49,573	Dec-22	14.2	13.1	2.0	15.8	3.0	4.0	3.4
Avg.								26.5	20.5	4.1	15.7	1.6	3.3	(11.4)
Med.								18.3	15.6	3.1	15.8	1.5	2.3	(12.3)

Source: Bloomberg, Company data, CMBIGM estimates, *covered by Joseph Wong

Figure 5: Forward 12M P/E valuation band

Source: Bloomberg, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (US\$ mn)						
Revenue	8,263	9,853	9,569	11,217	12,576	14,120
Cost of goods sold	(2,342)	(2,812)	(2,836)	(3,290)	(3,656)	(4,095)
Gross profit	5,921	7,041	6,733	7,927	8,920	10,025
Operating expenses	(5,245)	(6,298)	(6,010)	(6,649)	(7,406)	(8,145)
Selling expense	0	0	0	0	0	0
Admin expense	(591)	(663)	(704)	(796)	(868)	(946)
Staff costs	(1,730)	(2,258)	(2,389)	(2,684)	(3,010)	(3,351)
Other rental related expenses	(814)	(968)	(957)	(1,075)	(1,186)	(1,310)
Others	(1,660)	(1,893)	(1,358)	(1,519)	(1,720)	(1,870)
Operating profit	961	1,386	629	1,301	1,552	1,923
Other income	285	643	(94)	22	38	42
Share of (losses)/profits of associates/JV	0	0	0	0	0	0
EBITDA	1,411	1,902	1,231	1,875	2,174	2,591
Depreciation	(431)	(505)	(582)	(514)	(565)	(628)
Other amortisation	(19)	(11)	(20)	(60)	(57)	(40)
Interest income	43	60	84	113	149	184
Interest expense	0	0	0	0	0	0
Net Interest income/(expense)	43	60	84	113	149	184
Other income/expense	104	(54)	(26)	(30)	(34)	(38)
Pre-tax profit	1,108	1,392	687	1,383	1,667	2,069
Income tax	(295)	(369)	(209)	(415)	(417)	(517)
After tax profit	813	1,023	478	968	1,250	1,551
Minority interest	(29)	(33)	(36)	(69)	(83)	(103)
Net profit	784	990	442	899	1,167	1,448

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (US\$ mn)						
Current assets	4,936	4,716	3,940	5,315	6,572	7,889
Cash & equivalents	1,158	1,136	1,130	2,364	3,513	4,704
Restricted cash	3,105	2,860	2,022	2,022	2,022	2,022
Account receivables	99	67	64	77	86	97
Inventories	398	432	417	492	547	613
Prepayment	176	221	307	360	403	453
Other current assets	0	0	0	0	0	0
Non-current assets	5,939	8,507	7,886	7,508	7,422	7,531
PP&E	1,765	2,251	2,118	2,333	2,523	2,671
Right-of-use assets	2,164	2,612	2,219	2,219	2,219	2,219
Investment in JVs & assos	85	292	266	266	266	266
Intangibles	246	272	159	99	42	2
Goodwill	832	2,142	1,988	1,455	1,237	1,237
Other non-current assets	847	938	1,136	1,136	1,136	1,136
Total assets	10,875	13,223	11,826	12,823	13,994	15,420
Current liabilities	2,067	2,383	2,166	2,397	2,585	2,805
Short-term borrowings	0	0	0	0	0	0
Account payables	708	830	830	963	1,070	1,198
Tax payable	72	51	68	68	68	68
Other current liabilities	1,287	1,502	1,268	1,366	1,447	1,538
Non-current liabilities	2,337	2,918	2,500	2,500	2,500	2,500
Long-term borrowings	0	0	0	0	0	0
Other non-current liabilities	2,337	2,918	2,500	2,500	2,500	2,500
Total liabilities	4,404	5,301	4,666	4,897	5,085	5,305
Share capital	4,829	4,967	4,291	4,291	4,291	4,291
Retained earnings	2,105	2,892	2,191	2,621	3,441	4,459
Other reserves	(463)	63	678	1,014	1,177	1,364
Total shareholders equity	6,471	7,922	7,160	7,926	8,909	10,114
Minority interest	0	0	0	0	0	0
Total equity and liabilities	10,875	13,223	11,826	12,823	13,994	15,418

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (US\$ mn)						
Operating						
Profit before taxation	1,108	1,392	687	1,383	1,667	2,069
Depreciation & amortization	450	516	602	574	622	668
Tax paid	111	160	(20)	(415)	(417)	(517)
Change in working capital	69	53	0	90	80	94
Others	(624)	(990)	144	533	219	1
Net cash from operations	1,114	1,131	1,413	2,165	2,171	2,314
Investing						
Capital expenditure	(419)	(689)	(679)	(729)	(755)	(777)
Acquisition of subsidiaries/ investments	(288)	(115)	(23)	0	0	0
Others	(2,402)	(51)	180	0	0	0
Net cash from investing	(3,109)	(855)	(522)	(729)	(755)	(777)
Financing						
Dividend paid	(95)	(203)	(202)	(202)	(267)	(347)
Net borrowings	0	0	0	0	0	0
Proceeds from share issues	2,195	0	0	0	0	0
Share repurchases	(8)	(75)	(466)	0	0	0
Others	(34)	(35)	(176)	0	0	0
Net cash from financing	2,058	(313)	(844)	(202)	(267)	(347)
Net change in cash						
Cash at the beginning of the year	1,046	1,158	1,136	1,130	2,364	3,513
Exchange difference	40	15	(53)	0	0	0
Others	72	(37)	47	1,234	1,149	1,191
Cash at the end of the year	1,158	1,136	1,130	2,364	3,513	4,704
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	(5.8%)	19.2%	(2.9%)	17.2%	12.1%	12.3%
Gross profit	(6.0%)	18.9%	(4.4%)	17.7%	12.5%	12.4%
Operating profit	6.7%	44.2%	(54.6%)	106.8%	19.3%	23.9%
EBITDA	6.2%	34.8%	(35.3%)	52.3%	16.0%	19.2%
Net profit	10.0%	26.3%	(55.4%)	103.4%	29.8%	24.1%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	71.7%	71.5%	70.4%	70.7%	70.9%	71.0%
Operating margin	11.6%	14.1%	6.6%	11.6%	12.3%	13.6%
EBITDA margin	17.1%	19.3%	12.9%	16.7%	17.3%	18.3%
Return on equity (ROE)	16.3%	13.8%	5.9%	11.9%	13.9%	15.2%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Current ratio (x)	2.4	2.0	1.8	2.2	2.5	2.8
Receivable turnover days	4.1	3.1	2.5	2.5	2.5	2.5
Inventory turnover days	60.6	53.9	54.6	54.6	54.6	54.6
Payable turnover days	103.7	99.8	106.8	106.8	106.8	106.8
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	31.5	26.9	58.7	28.2	22.2	17.9
P/E (diluted)	31.5	26.9	58.7	28.2	22.2	17.9
P/B	3.8	3.4	3.4	3.2	2.9	2.5
P/CFPS	18.1	22.9	14.1	11.6	11.9	11.2
Div yield (%)	0.5	0.8	1.1	1.1	1.4	1.7

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong. Tel: (852) 3900 0888 Fax: (852) 3900 0800

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